87-479

No.

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1987

ENERGY COOPERATIVE, INC.,
JAY A. STEINBERG, TRUSTEE,

Petitioner,

v.

PHILLIPS PETROLEUM COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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RULE 28.1 LIST

This petition is being filed by a trustee, Jay A. Steinberg, on behalf of the estate of the debtor, Energy Cooperative, Inc. Pursuant to Rule 28.1, the former member owners of the debtor corporation were:

Farmers Union Central Exchange, Inc. (CENEX)

FCX, Inc.

Farmers Petroleum Cooperative, Inc.

Landmark, Inc.

Land O' Lakes, Inc.

MFA Oil Company

Midland Cooperatives, Incorporated[1]

Tennessee Farmers Cooperative

CF Industries, Inc.[2]

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[1] Midland Cooperatives, Incorporated merged into Land O'Lakes, Inc. effective 1/1/82.

[2] Effective 11/30/78 ECI redeemed the interests of CF Industries, Inc.

QUESTIONS PRESENTED

1. What is the federal rule regarding what constitutes the same cause of action for purposes of *res judicata*?

2. Where a bankruptcy court has reserved claims for later adjudication, should *res judicata* be applied in a way that defeats creditors' rights to notice, a hearing and appropriate findings of fact before those claims are barred?

LIST OF PARTIES

The Plaintiff-Appellant in the United States Court of Appeals for the Seventh Circuit was Petitioner Energy Cooperative, Inc., Jay A. Steinberg, Trustee. The Defendant-Appellee in the Seventh Circuit was Respondent Phillips Petroleum Company.

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PHILLIPS PETROLEUM COMPANY,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The petitioner Energy Cooperative, Inc., Jay A. Steinberg, Trustee, respectfully requests that a writ of certiorari issue to review the judgment and decision of the United States Court of Appeals for the Seventh Circuit, entered on March 24, 1987, as modified on June 10, 1987.

OPINIONS BELOW

The decision of the Court of Appeals for the Seventh Circuit from which certiorari is sought, dated March 24, 1987, affirming the decision of the district court, appears as

Appendix A hereto and, as modified by the Order on Petition for Rehearing dated June 10, 1987, is reported at 814 F. 2d 1226. The order of the Seventh Circuit denying the petition for rehearing, dated June 10, 1987, is not reported but is printed as Appendix H hereto.

The Memorandum Decision of the United States District Court for the Northern District of Illinois, Eastern Division (Kocoras, J.) has not been reported. It appears as Appendix D hereto.

JURISDICTION

The judgment of the United States Court of Appeals for the Seventh Circuit was entered on March 24, 1987, affirming the decision of the District Court. The Court of Appeals modified its opinion and denied a timely Petition for Rehearing on June 10, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

STATUTES INVOLVED

11 U.S.C. §547 is set forth as Appendix N.

11 U.S.C. §553 is set forth as Appendix M.

STATEMENT OF THE CASE

The debtor in this bankruptcy case, Energy Cooperative, Inc. ("ECI"), operated a petroleum refinery in East Chicago, Indiana. In the course of its business, ECI traded petroleum products with other oil companies pursuant to "exchange agreements." Phillips was one such company.

On May 15, 1981, ECI filed a voluntary petition under chapter 11 of the Bankruptcy Code, 11 U.S.C. §1101 *et*

seq.[1] Thereafter, ECI operated its business as a debtor-in-possession under the provisions of Chapter 11.[2]

Following notice to ECI's creditors, the bankruptcy court entered an order authorizing ECI, as the debtor-in-possession, to compromise, settle and collect balances resulting from its pre-bankruptcy exchange transactions. (App. I, J) (That order is referred to in this petition as the "Compromise Authorization Order.") As construed by the Seventh Circuit (App. A-15) the Compromise Authorization Order prohibited ECI from settling preference claims against exchange partners on the authority of that Order.[3]

Unable to settle its account with Phillips, ECI filed a lawsuit to collect the exchange balance due from Phillips. That case was "settled" when Phillips delivered the exact quantity of petroleum products alleged to be due.[4] The

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[1] Because ECI filed its bankruptcy petition prior to the effective date of the 1984 amendments to the Bankruptcy Code, the bankruptcy issues in this case are governed by the Code prior to its amendment. The citations to the Code will be to its pre-amendment version.

[2] Jay A. Steinberg was appointed Trustee for the ECI estate when the case was later converted to a case under Chapter 7.

[3] The Compromise Authorization Order, as amended, authorized ECI "to negotiate and agree with each of the Exchange Partners upon a final settlement and liquidation of the obligations remaining under each respective Exchange Agreement" and "where appropriate, to adjust and compromise any disputed amounts or obligations owing under the Exchange Agreements," (App. I-6) with the following proviso:

> "that the Debtor has no authority to settle, adjust or compromise any claim, cause or right, which claim, cause or right could form the basis of any cause of action which may be brought pursuant to any avoiding or recovery provisions of the Bankruptcy Code."

(App. J-5)

[4] Phillips never answered the complaint. The only dispute that ever existed was whether ECI was entitled to be paid the

(Footnote continued on the following page)

collection case was dismissed with prejudice on ECI's motion on September 22, 1985. No notice or opportunity to be heard was given to all creditors and other parties in interest; nor was any showing made of cause for dispensing with such notice before the collection case was dismissed by agreement. In its order dismissing the account collection case, the bankruptcy court made no finding of fact with respect to any potential preference claim or that the settlement was in the best interests of the estate.

On October 14, 1982, approximately three weeks after the account collection case was dismissed, ECI filed the complaint against Phillips that is the basis of this petition. The suit sought to avoid preferential transfers or payments made to Phillips by ECI within 90 days prior to ECI's filing its bankruptcy petition. The transfers sought to be avoided were deliveries by ECI in the course of its product exchanges with Phillips. The preference complaint alleged the elements set out in 11 U.S.C. 547(b): (1) ECI filed a bankruptcy petition; (2) some of ECI's deliveries under the exchange were for or on account of an antecedent debt; (3) those deliveries were made within ninety days before bankruptcy; (4) ECI was insolvent when those deliveries were made; and (5) those deliveries enabled Phillips to receive a greater share of its debt than it otherwise would have received in a Chapter 7 case. 11 U.S.C. §547 (West Supp. 1981) (effective 1978).

The district court (which had assumed jurisdiction by withdrawing the reference of this proceeding to the bankruptcy court) granted Phillips' motion to dismiss on November 7, 1985. The court relied upon the *res judicata* grounds alleged by Phillips, as well as the doctrine of equi-

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4 *(Continued)*

money value of the petroleum products or had to accept the petroleum products themselves. There was no dispute about the quantity of petroleum products due.

table estoppel, which had not been alleged by Phillips. On January 29, 1986 the district court denied the Trustee's motion to vacate its earlier order granting Phillips' motion to dismiss.

The Trustee then appealed to the appellate court, which, on March 24, 1987 affirmed the district court's decision, holding that the suit was barred by res judicata. The appellate court denied the Trustee's petition for rehearing and modified its opinion on June 10, 1987.

REASONS FOR GRANTING THE WRIT

I. This Court should exercise its supervisory powers to resolve the confusion and conflict among and within the circuits regarding the proper standard for determining what constitutes the same cause of action for purposes of *res judicata.*

The Seventh Circuit relied on what it called the federal rule of *res judicata*, disregarding state cases. But there is great confusion among and within circuits about the doctrine of *res judicata*. If there is ever to be a federal rule this Court will have to announce it. It is particularly important to establish a uniform and clear standard because of the consequences of losing meritorious causes of action in the confusion.

ECI has fallen into a trap created by the uncertainty as to what constitutes a cause of action for purposes of *res judicata*, as well as the Seventh Circuit's stretching of the doctrine of *res judicata* into a rule of compulsory litigation.

As Professor Moore has stated,

> The cases that adumbrate the distinction between a single claim based on different theories and separate claims arising from the same nucleus of operative fact are not easy to reconcile. Various tests have been suggested, among them: (1) whether the same right is infringed by the same wrong; [(2)] (sic) whether a contrary decision in

> the second action would impair or destroy rights or interests established by the first judgment; (3) identity of grounds; and (4) whether the same evidence would suffice to support both judgments.

1B J. Moore, J. Lucas & T. Currier, *Moore's Federal Practice* ¶ 0.410 [1] at 355-57, (2d ed. 1984).

The Seventh Circuit's approach in this case was much broader than any of those tests. It attempted to apply a test commonly referred to as the "transactional" approach, as stated in *Car Carriers, Inc. v. Ford Motor Co.*, 789 F. 2d 589 (7th Cir. 1986). The circuits have submitted a variety of formulations of the "transactional" approach from which no clear federal rule can be derived and have arrived at inconsistent results. Nor have all the circuits adopted any form of the "transactional" approach as the federal rule. What constitutes a cause of action for purposes of res judicata varies among the circuits and sometimes within circuits, including the Seventh Circuit.

The First Circuit has officially adopted the "transactional" approach, focusing on "whether the underlying facts of both transactions were the same or substantially similar." *Manego v. Orleans Board of Trade*, 773 F. 2d 1, 6 (1st Cir. 1985), *cert. denied*, 54 U.S.L.W. 3630, 106 S.Ct. 1466, 89 L.Ed.2d 722 (1986). But the narrower "same right" and "same evidence" tests appear still to be very much alive in that circuit. *See Sierra Club v. Secretary of Transp.*, 779 F. 2d 776 (1st Cir. 1985).

The Second Circuit may have adopted a test other than the "transactional" approach. According to *Herendeen v. Champion Intern. Corp.* 525 F. 2d 130 (2nd Cir. 1975), the "relevant criteria" are "whether a different judgment in the second action would impair or destroy rights or interests established by the judgment entered in the first action, whether the same evidence is necessary to maintain the second cause of action as was required in the first, and whether the essential facts and issues in the second were

present in the first." *Herendeen* at 133-134. *See also Board of Ed. of the City Sch. Dist. v. Hufstedler*, 641 F. 2d 68 (2nd Cir. 1981); *N.L.R.B. v. United Technologies Corp.*, 706 F. 2d 1254 (2nd Cir. 1983); and *Tucker v. Arthur Andersen & Co.*, 646 F. 2d 721 (2nd Cir. 1981) (all adopting the *Herendeen* test); and *McNellis v. First Federal Sav. & L. Ass'n of Rochester, N.Y.*, 364 F. 2d 251 (2nd Cir. 1966). *Expert Electric, Inc. v. Levine*, 554 F. 2d 1227 (2nd Cir.), *cert. denied*, 434 U.S. 903 (1977) , however, hints at a "transactional" approach stating, "[t]he crucial element underlying all of these standards is the factual predicate of the several claims asserted." *Expert Electric* at 1234. *See also Ellentuck v. Klein*, 570 F. 2d 414 (2nd Cir. 1978) and *Berlitz Schools of Languages, Etc. v. Everest House*, 619 F. 2d 211 (2nd Cir. 1980). The most recent case in the Second Circuit, *In re Teltronics Services, Inc.*, 762 F. 2d 185 (2nd Cir. 1985) espouses no specific test.

The Third Circuit also seems not to have adopted the "transactional" approach as the federal standard. In determining what constitutes the same cause of action, the Third Circuit looks to "(1) whether the acts complained of and the demand for relief are the same (that is, whether the wrong for which redress is sought is the same in both actions. . . .); (2) whether the theory of recovery is the same; (3) whether the witnesses and documents necessary at trial are the same (that is, whether the same evidence necessary to maintain the second action would have been sufficient to support the first) . . . and (4) whether the material facts alleged are the same." *Purter v. Heckler*, 771 F. 2d 682, 690 (3rd Cir. 1985), quoting *United States v. Athlone Industries, Inc.*, 746 F. 2d 977, 984 (3rd Cir. 1984). *See also Williamson v. Columbia Gas & Electric Corp.*, 186 F. 2d 464, 470 (3rd Cir. 1950); *Donegal Steel Foundry Co. v. Accurate Products Co.*, 516 F. 2d 583, 588 (3rd Cir. 1975); *Davis v. United States Steel Supply, Etc.*, 688 F. 2d 166, 171 (3rd Cir. 1982), *cert. denied*, 460 U.S. 1014 (1983). *Athlone* and *Davis* add the idea that "[t]hese factors are

the components of 'an essential similarity of the underlying events. . . .' " *Athlone* at 984. *See also Davis* at 171.

A couple of Fourth Circuit decisions have adopted the "transactional" approach. *See Harnett v. Billman*, 800 F. 2d 1308 (4th Cir. 1986) *cert. denied*, 55 U.S.L.W. 3643, 107 S.Ct. 1571, 94 L.Ed. 2d 763 (1987) and *Adkins v. Allstate Ins. Co.*, 729 F. 2d 974 (4th Cir. 1984). It is by no means clear, however, that that is the predominant test in the Fourth Circuit. *See Nash Cty. Bd. of Ed. v. Biltmore Co.*, 640 F. 2d 484, 487 (4th Cir.), *cert. denied*, 454 U.S. 878 (1981), *reh'g. denied*, 454 U.S. 1117 (1981) ("The authorities do not provide any precise uniform definition of 'cause of action' in connection with the application of *res judicata.*") and *Bittner v. West Virginia - Pittsburgh Coal Co.*, 15 F. 2d 652, 655 (4th Cir. 1926) (Referring to the "same evidence" test: "It has been said that this method is the best and most accurate test. . . ." (quoting 15 R.C.L. topic "Judgments," §439)).

The Fifth Circuit law is particularly confused. In *Nilsen v. City of Moss Point, Miss.* 701 F.2d 556 (5th Cir. 1983), the Fifth Circuit, sitting *en banc*, stated that "this Court has recognized that the principal test for comparing causes of action is whether the primary right and duty or wrong are the same in each action." *Nilsen* at 559 (quoting *Kemp v. Birmingham News Co., Mobile, Alabama*, 608 F.2d 1049, 1052 (5th Cir. 1979) (citing *Stevenson v. International Paper Co.*, 516 F.2d 103, 109 (5th Cir. 1975))). *See also White v. World Finance of Meridian, Inc.*, 653 F.2d 147, 150 (5th Cir. 1981); *Hayes v. Solomon*, 597 F.2d 958, 983 (5th Cir. 1979), *cert. denied*, 444 U.S. 1078 (1980); *Hall v. Tower Land and Investment Company*, 512 F.2d 481, 483 (5th Cir. 1975); *Carr v. United States*, 507 F.2d 191, 193 (5th Cir. 1975); and *Maher v. City of New Orleans*, 516 F.2d 1051, 1057 (5th Cir. 1975), *cert. denied*, 426 U.S. 905 (1976) (all embracing the "primary right" test). But, inconsistently, in a footnote, *Nilsen* stated that "the transactional test

of a 'claim' enunciated by the Restatement . . . represents the modern view and that we prefer to our earlier writings in *Kemp* . . . . " *Nilsen* at 560 n.4. Although *Nilsen* clearly applied the "primary right" test, some Fifth Circuit panels have aggressively read this footnote as indicating that the Fifth Circuit has embraced the "transactional" approach to the exclusion of any other test. *See Robinson v. National Cash Register Co.*, 808 F.2d 1119, 1124 (5th Cir. 1987); *Nagel v. Lee*, 807 F.2d 435, 439-440 (5th Cir. 1987); *Ocean Drilling & Explor. v. Mont Boat Rental Serv.*, 779 F.2d 213, 217 (5th Cir. 1986); *Southmark Properties v. Charles House Corp.*, 742 F.2d 862, 870-871 (5th Cir. 1984); and *United Home Rentals v. Texas Real Estate Com'n*, 716 F.2d 324, 328 (5th Cir. 1983), *cert. denied*, 466 U.S. 928 (1984). One panel dealt with the situation by applying both the "primary right" test and the "transactional" test. *See Jackson v. United States Postal Service*, 799 F.2d 1018 (5th Cir. 1986).

Sixth Circuit opinions are split among the "same evidence" test, the "same wrong" test and the "transactional" approach. *See Silcox v. United Trucking Service, Incorp.*, 687 F.2d 848, 852 (6th Cir. 1982) and *James v. Gerber Products Company*, 587 F.2d 324, 328 n. 5 (6th Cir. 1978) (both applying the "transactional" approach); *Westwood Chemcial Co., Inc. v. Kulick*, 656 F.2d 1224, 1227 (6th Cir. 1981) (stating that "to constitute a bar, there must be an identity of the causes of action – that is, an identity of the facts creating the right of action and of the evidence necessary to sustain each action."); *King v. South Cent. Bell Telephone and Telegraph*, 790 F.2d 524, 528 (6th Cir. 1986) (quoting *Westwood*); and *Cemer v. Marathon Oil Company*, 583 F.2d 830, 832 (6th Cir. 1978) ("single wrong").

In the Seventh Circuit, relying on the same authority relied upon by the panel that decided this case, a different panel came to the opposite conclusion in *United States v. Ryan*, 810 F. 2d 650 (7th Cir. 1987). The Seventh Circuit

panel in *Ryan* asserted that "[i]n this circuit, a 'cause of action' is 'a single core of operative facts which give rise to a remedy.' *Car Carriers*, 789 F. 2d at 593." *Id.* at 654. In determining whether the two proceedings at issue arose out of a common core of operative facts, the panel applied what amounts to the "same evidence" test, without calling it by that name. The court stated:

> To find Schwener and Ryan in civil contempt, the only necessary facts were that the court ordered them to testify and that they did not do so. To find Schwener and Ryan guilty of criminal contempt under 18 U.S.C. §401, however, the government was required to prove, beyond a reasonable doubt, not only that each defendant was aware of an order that he testify, but that each defendant willfully disobeyed that order.

Id.

The Seventh Circuit's opinion in this case, however, goes far beyond the nearly contemporaneous opinion in *Ryan* in applying its version of the "transactional" test stating:

> Because each claim seeks to reconcile the parties' obligations under their contract and because the time periods covered by the two claims overlap, we conclude that the two arise out of the same transaction.
>
> The link between the two claims is also supported by the relationship between the claims and Phillips' right of setoff.

(App. A-9)

The Seventh Circuit's reliance on setoff as a link shows how broad a test it is using. Mutual debts may be set off no matter how disparate the transaction from which they arise. *See e.g. In re IML Freight, Inc.*, 65 B.R. 788 (Bankr. D. Utah 1986).

The Eighth Circuit has used three different tests. Some cases assert that "the primary test for comparing

causes of action has long been whether or not the primary right and duty, and the delict or wrong combined are the same in each action." *Engelhardt v. Bell & Howell Co.*, 327 F.2d 30 (8th Cir. 1964) (citing *Baltimore S.S. Co. v. Phillips*, 274 U.S. 316, (8th Cir. 1926)). *See also Towle v. Boeing Airplane Company*, 364 F.2d 590, 592 (8th Cir. 1966), *Rhodes v. Jones*, 351 F.2d 884, 887 (8th Cir. 1965) and *Rhodes v. Myer*, 334 F.2d 709, 712 (8th Cir. 1964) (all quoting *Engelhardt*); and *Robbins v. District Court of Worth Cty., Iowa*, 592 F.2d 1015, 1017 (8th Cir. 1979) (citing *Englehardt* and noting that an additional *res judicata* requirement for constitutional issues in §1983 actions is whether "the second suit concerns the 'same operative nucleus of fact'."), *cert. denied*, 444 U.S. 852 (1979).). A second group of decisions relies on a similar test, asking "whether the wrong for which redress is sought is the same in both actions." *Roach v. Teamsters Local Union No. 688*, 595 F.2d 446, 449 (8th Cir. 1979) (quoting *Woodbury v. Porter*, 158 F.2d 194, 195 (8th Cir. 1946). *See also Mid-continent Broadcasting v. Dresser Industries*, 669 F.2d 564, 566 (8th Cir. 1982) (applying "same wrong" test with an allusion to "same operative facts."); and *Hanson v. Hunt Oil Company*, 505 F.2d 1237, 1240 (8th Cir. 1974) (quoting *Woodbury*). Only one opinion has applied the "transactional" approach. *See Poe v. John Deere Co.*, 695 F.2d 1103, 1106 (8th Cir. 1982). *See also Brown v. St. Louis Police Dept. Etc.*, 691 F.2d 393, 396 n.2 (8th Cir. 1982) (stating that it would apply the "transactional" approach "if it were necessary to fashion a rule of federal law in this case."), *cert. denied*, 461 U.S. 908 (1983).

A number of tests compete in the Ninth Circuit. *Harris v. Jacobs*, 621 F.2d 341 (9th Cir. 1980) is the leading case in the Ninth Circuit. *Harris* adopts a four-pronged test which examines "(1) whether rights or interests established in the prior judgment would be destroyed or impaired by prosecution of the second action; (2) whether substantially the same evidence is presented in the two

actions; (3) whether the two suits involve infringement of the same right; and (4) whether the two suits arise out of the same transactional nucleus of facts." 621 F.2d at 343. Despite the *Harris* court's assertion that "the crucial element underlying all of the standards is the factual predicate of the several claims asserted" *Id.* (quoting *Expert Electric, Inc. v. Levine*, 554 F.2d 1227 at 1234.), *Harris* ignored the "transactional" portion of the test it espoused, applying only the first three prongs of the test. Most of the *Harris* progeny have applied all four tests. *see Intern. Ass'n of Machinists v. Aloha Airlines*, 790 F. 2d 727, 731-732 (9th Cir. 1985), *cert. denied*, 55 U.S.L.W. 3315 (1986); *Shapley v. Nevada Bd. of State Prison Com'rs*, 766 F.2d 404, 406-408 (9th Cir. 1985); and *Costantini v. Trans World Airlines*, 681 F.2d 1199, 1201-1202 (9th Cir. 1982), *cert. denied*, 459 U.S. 1087 (1982) (all applying all four prongs). *But see Amaro v. Continental Can Co.*, 724 F.2d 747, 749 (9th Cir. 1984) (applying only the third prong). Outside of *Harris* and its progeny, the circuit is for the most part split between the "transactional" approach, *see Sidney v. Zah*, 718 F.2d 1453, 1458-1459 (9th Cir. 1983) and *Brown v. Federated Department Stores*, 653 F.2d 1266, 1267 (9th Cir. 1981), and the "same right" or "primary right" tests, *McClain v. Apodaca*, 793 F.2d 1031, 1033-1034 (9th Cir. 1986) and *Jackson v. Hayakawa*, 605 F.2d 1121, 1125 (9th Cir. 1979), *cert. denied*, 445 U.S. 952 (1980). *Abramson v. University of Hawaii*, 594 F.2d 202, 207 (9th Cir. 1979), looks at the "coincidence of issues." *United States v. Truckee-Carson, Etc.*, 649 F.2d 1286, 1301-1302 (9th Cir. 1981), *modified*, 666 F.2d 351 (1982), *aff'd in part* and *rev'd in part, Nevada v. United States*, 463 U.S. 110, *reh'g denied*, 464 U.S. 875 (1983), applies the "same evidence" test, finds it "undeterminative" and looks instead to the intentions of the litigants, lawyers and judges.

The Tenth Circuit has used the "same right" and "same evidence" tests, *see Louis Cook Plumbing & Heating, Inc. v. Frank Briscoe Co.*, 445 F.2d 1177, 1179 (10th

Cir. 1984), as well as a narrow interpretation of a test that looks to "the reasonable expectation of the parties . . . ." *Long v. United States Dept. of Air Force*, 751 F.2d 339, 345 (10th Cir. 1984).

The Eleventh Circuit is evenly divided between the "primary right and wrong" test, *see I.A. Durbin, Inc. v. Jefferson Nat. Bank*, 793 F.2d 1541, 1549 (11th Cir. 1986) and *Ray v. Tennessee Valley Authority*, 677 F.2d 818, 821 (11th Cir. 1982) *reh'g denied*, 683 F.2d 1375, *cert. denied* 459 U.S. 1147 (1983), the "operative facts" test, *Olmstead v. Amoco Oil Co.*, 725 F.2d 627, 632 (11th Cir. 1984), and a very general formulation of the "transactional" approach, *Hart v. Yamaha - Parts Distributors, Inc.*, 787 F.2d 1468, 1470 (11th Cir. 1986).

The District of Columbia Circuit applies both the "transactional" approach and the "primary right" test. *U.S. Industries, Inc. v. Blake Const. Co., Inc.*, 765 F.2d 195 (D.C. Cir. 1985) applies the "transactional" approach and asserts that the D.C. Circuit embraced that test in *I.A.M. Nat.'l Pension Fund v. Industrial Gear Mfg.*, 723 F.2d 944 (D.C. Cir. 1983). In fact, *Industrial Gear* applies both the "transactional" approach and the "primary right" test. 723 F.2d at 948.

The Federal Circuit has adopted the "transactional" approach. *See Chromalloy American Corp. v. Kenneth Gordon*, 736 F.2d 694, 697 (Fed. Cir. 1984) and *Young Engineers v. U.S. Intern. Trade Com'n*, 721 F.2d 1305, 1314 (Fed. Cir. 1983).

The reason the law of the circuits has become confused on this subject is the lack of any unequivocal recent statement by this Court. This Court most recently addressed the principle of *res judicata* in *Nevada v. United States*, 463 U.S. 110 (1983), *reh'g denied*, 464 U.S. 875 (1983), In that case, the Court asserted that "[d]efinitions of what constitutes the 'same cause of action' have not remained static over time." *Nevada* at [L Ed 525]. (Citations omitted). But

in that case the Court did not need to determine which of those tests is currently the appropriate one.

This Court has not given the circuits any clear guidance regarding what constitutes the same cause of action for purposes of *res judicata* since *Baltimore S.S. Co. v. Phillips*, 274 U.S. 316 (1927) and *The Haytian Republic*, 154 U.S. 118 (1894). In neither case did this Court approve the "transactional" approach.

In *Haytian Republic* the Court stated: "One of the tests laid down for the purpose of determining whether or not the causes of action within the rule of re judicata, should have been joined in one suit is whether the evidence necessary to prove one cause of action would establish the other." *Haytian Republic*, 154 U.S. at 125. In *Baltimore Steamship* this Court espoused the "same right" test: "The number and variety of the facts alleged do not establish more than one cause of action so long as their result, whether they be considered severally or in combination, is the violation of but one right by a single legal wrong." *Baltimore Steamship*, 274 U.S. at 317.

Thus, the circuits, to the extent they are deviating from the "same evidence" or "single legal wrong" theory, are establishing a federal rule unsupported by any holding of this Court. Now, over sixty years since this Court's last pertinent decision, it is time for this Court to define a federal rule of *res judicata*. It is time to either clarify the "transactional" definition of what constitutes the same cause of action, or do away with that standard altogether.

Even if this Court determines that the "transactional" approach is the proper test for determining what constitutes the same cause of action, the Seventh Circuit has set a dangerous precedent in its application of that standard.

The Seventh Circuit's decision is *not* simply an application of the "transactional" approach as described in that Circuit's decision in *Car Carriers*, but goes significantly beyond *Car Carriers* in the way it analyzes causes of action.

In *Car Carriers*, but not this case, the court looked to the factual basis of the two claims to determine whether one set of facts ("single core of operative facts") gave rise to both claims. In *Car Carriers*, the Seventh Circuit, applying the "same transaction test" to RICO and antitrust claims, quoted and approved the reasoning of the District Court:

> Like the present RICO claims, the earlier antitrust claims alleged Ford induced Car Carriers to make investments it could not recoup. Like the earlier antitrust claims, the current RICO claims allege Car Carriers was terminated due to a sham and predatory bid, and Ford and Nu-Car refused to buy Car Carriers' assets upon its termination.
>
> 583 F. Supp. at 226 (footnote omitted). We agree; the RICO and Sherman Act claims arose out of a single core of operative facts and, thus, were parts of the same cause of action.

Car Carriers, 789 F. 2d at 595. If that analysis were undertaken here, it would be clear that there are two separate causes of action. No netting out of transactions, or reconciliation of obligations under the exchange agreement could possibly yield even one of the elements of a preference claim. On the other hand, none of the elements of the preference claim is even relevant to the exchange balance claim. What the Seventh Circuit has done is to significantly expand the doctrine of *res judicata* beyond what it has ever been in that or any other circuit.

The Seventh Circuit has brought forth the worst nightmares of commentators who have warned about too broad an expansion of *res judicata*. *(See, e.g.*, C. Wright, A. Miller, & E. Cooper, *Federal Practice and Procedure* §4407 (1981) at 56 (1981); F. James & G. Hazard, *Civil Procedure* §11.8 (3d ed. 1985)). The Seventh Circuit has expanded the limits of "cause of action" far beyond the parameters of permissible joinder of causes. Plaintiffs now *must* join all claims they *may* join. Parties will now have to "scrape

the bottom of the barrel to find and include possible claims which they are not willing to have altogether cut off as a result of their own affirmative conduct (in bringing suit), although the same parties may be willing to let these claims drift if their hand is not forced." James & Hazard at 600. This result destroys the very values the doctrine of *res judicata* seeks to promote. Additionally, this overly broad rule of *res judicata* "will prove a greater trap for the unwary." James & Hazard at 600.

These problems are particularly evident in bankruptcy, where in the chaotic early days of a major Chapter 11 case the filing of preference claims is generally a matter of discretion. Often, a debtor early in the case will not deem it in its interests to pursue preferences. But the Seventh Circuit has mandated that debtors must "use it or lose it." This proclamation will effectively force debtors to file claims inappropriately.

In bankruptcy, forcing debtors to pursue preference claims they might choose to forego unnecessarily overloads the court system and needlessly harasses creditors. Forcing debtors to litigate also wastes precious estate resources that might otherwise be used to satisfy the very creditors that the debtors are instead being forced to sue.

The attorneys for ECI were told before preparing the complaint in the account claim matter that Phillips owed an account balance of about $ 1.5 million worth of petroleum products to ECI. That was sufficient to frame a complaint. But now, it appears, they should have asked ECI and its accountants a series of questions bearing no relationship whatsoever to the account claim: Were any transfers made by ECI during the 90 days preceding bankruptcy? If so, was ECI insolvent when those transfers were made? Were any of those transfers made at a time that ECI owed a debt to Phillips, and were they made on account of that antecedent debt? Did Phillips receive more because it received those transfers than it

would have if ECI had not made them and Phillips received what it would be entitled to receive under Chapter 7 of the Bankruptcy Code?

The doctrine of *res judicata* should not be so broad that it forces this kind of fishing for lawsuits by attorneys concerned about the implications of this doctrine.

II. The Seventh Circuit has improperly deprived creditors of their right to notice and a hearing before the compromise of a claim.

The Seventh Circuit held that, "ECI was not authorized by the Compromise Authorization Order to settle any preference claims it might have against Phillips." (App. A-15). The Seventh Circuit went on to hold, however, that "this order was modified as to Phillips when the court approved the settlement of the account balance suit 'with prejudice.'" *Id.*

The order dismissing the account balance suit was entered without notice to creditors. The effect of the court's holding, therefore, is to render the bankruptcy court's order dismissing the account balance suit a deprivation of creditors' due process and statutory rights to notice.[5]

Creditors have a clear right to notice of compromises of claims because they have an economic interest in the assets of a bankruptcy estate, including its claims. *See*, Rules Bankr. Proc. Rule 9019(a); *Matter of Boston & Providence R. Corp.*, 673 F. 2d 11, 12 (1st Cir. 1982). This right to notice is not only a matter of bankruptcy rules, but of the due process clause of the Fifth Amendment to the United States Constitution. *In re Bramham*, 38 B.R. 459, 465-66 (Bankr. D. Nev. 1984).

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[5] The Seventh Circuit's construction of the words "with prejudice" in that order render that order's validity very questionable. Cf. *In re Lloyd, Carr and Co.*, 617 F. 2d 882, 885 (1st Cir. 1980) (alleged bankruptcy compromise without notice to creditors not valid).

Because of the importance of the rights and interests of creditors, the dismissal "with prejudice" should not be given an effect that deprives creditors of those rights and interests without notice.

An alternative holding of the Seventh Circuit was that the Compromise Authorization Order did not bar settlement of claims after a lawsuit was filed. We do not understand why a settlement after a lawsuit is filed is any different than a settlement before a lawsuit is filed. But, in any event, that distinction does not matter insofar as the rights of creditors are concerned. Whatever interpretation is given to the Compromise Authorization Order, creditors had a right to notice of the compromise. Plainly, the bankruptcy court did not intend to bar a claim for the benefit of creditors without giving those creditors their right to object, and the words "with prejudice" should not be so construed. The dismissal order should be given a scope consistent with both the rights of creditors and the terms of the Compromise Authorization Order.

CONCLUSION

For the foregoing reasons, the petitioner respectfully prays that this petition for certiorari be granted.

Respectfully submitted,

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